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No. 114

In the Supreme Court of the United States

OCTOBER TERM, 1929

FREDERICK C. RENZIEHAUSEN, PETITIONER

v.

ROBERT H. LUCAS, AS COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR RESPONDENT

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OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 39) is reported in 8 B. T. A. 87. The opinion of the United States Circuit Court of Appeals for the Third Circuit (R. 113) is reported in 31 F. (2d) 675.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on March 7, 1929. (R. 118–119.) Petition for certiorari was filed May 27, 1929. (R. 121.) Certiorari was granted October 14,

1929. (R. 120.) Jurisdiction is conferred upon this Court by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

Petitioner was engaged in the business of distilling and selling whiskey, and also in the wholesale liquor business. The Eighteenth Amendment was ratified by the requisite number of States January 16, 1919, and became effective January 16, 1920. The National Prohibition Act became effective January 16, 1920, and the Willis-Campbell Act November 23, 1921. The distillery ceased operations upon the passage of the Willis-Campbell Act. The questions are:

(1) Whether any portion of the March 1, 1913, value of petitioner's good will, trade marks, trade brands, or trade names is deductible for the years 1918 to 1921, inclusive (as respects the wholesale liquor business the period is 1918 to 1920), under the statutory allowance for "exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence."

(2) An alternative question is whether petitioner suffered a loss in the year 1919 of the good will, trade marks, trade brands, or trade names of the distillery business, which may be deductible under Section 214 (a) (4) of the Revenue Act of 1918. If so, the further question arises whether petitioner has shown the cost of such assets.

(3) Whether the taxpayer under the facts is entitled to deductions for obsolescence of plant and equipment of his distilling business for the years 1918 to 1921, inclusive, under Section 214 (a) (8) of the Revenue Acts of 1918 and 1921.

(4) Whether the taxpayer is entitled to have taxed as a capital gain under Section 206 of the Revenue Act of 1921 the profits realized on the sale in 1922 of certain old whiskey which he had held since its manufacture in his business more than two years prior to 1922.

STATUTES INVOLVED

Revenue Act of 1918, 40 Stat. 1057, 1066, 1067:

> SEC. 214. (a) That in computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;
>
> * * * * *
>
> (8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;
>
> * * * * *

Revenue Act of 1921, c. 136, 42 Stat. 227, 232, 233, 239, 240:

> SEC. 214. (a) That in computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (8) A reasonable allowance for the exhaustion, wear and tear of property used in

the trade or business, including a reasonable allowance for obsolescence. In the case of such property acquired before March 1, 1913, this deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913;

* * * * *

SEC. 206. (a) That for the purpose of this title:

(1) The term " capital gain " means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921;

(2) The term "capital loss" means deductible loss resulting from the sale or exchange of capital assets consummated after December 31, 1921;

(3) The term "capital deductions" means such deductions as are allowed under this title for the purpose of computing net income and are properly allocable to or chargeable against items of capital gain as defined in this section;

(4) The term "capital net gain" means the excess of the total amount of capital gain over the sum of the capital deductions and capital losses;

(5) The term "ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions; and

(6) The term "capital assets" as used in this section means property acquired and held by the taxpayer for profit or investment

for more than two years (whether or not connected with his trade or business), but does not include property held for the personal use or consumption of the taxpayer or his family, or stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year.

(b) In the case of any taxpayer (other than a corporation) who for any taxable year derives a capital net gain, there shall (at the election of the taxpayer) be levied, collected and paid, in lieu of the taxes imposed by sections 210 and 211 of this title, a tax determined as follows:

A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner provided in sections 210 and 211, and the total tax shall be this amount plus 12½ per centum of the capital net gain; but if the taxpayer elects to be taxed under this section the total tax shall in no such case be less than 12½ per centum of the total net income. The total tax thus determined shall be computed, collected and paid in the same manner, at the same time and subject to the same provisions of law, including penalties, as other taxes under this title.

* * * * *

STATEMENT

The taxpayer, Frederick C. Renziehausen, is a resident of Pittsburgh, Pennsylvania, and during the taxable years and prior thereto was the sole

owner of the whiskey distilling business conducted under the trade name of the Large Distilling Company. He also owned a one-half interest in the partnership of Schuetz, Renziehausen & Company, wholesale liquor dealers, Pittsburgh. (R. 31.)

In 1796 a whiskey-distilling business was founded by Jonathan Large under the trade name of the Large Distilling Company. From 1884 to 1897 this business was conducted as a partnership, composed of Henry Large, his wife, and the taxpayer. In 1897 the taxpayer became the sole owner of the business and thereafter conducted it as a sole proprietorship. (R. 31.)

The business of the Large Distilling Company was principally that of distilling whiskey, which it sold to wholesale liquor dealers under uniform contracts. It also carried on a warehousing business, storing the whiskey which it distilled in its bonded warehouses until matured and withdrawn by the owners, for which the latter paid certain monthly storage charges. It also bottled and cased the matured whiskey in bond, for which it received compensation from the owners thereof. At various times it purchased warehouse receipts for whiskey in its own bonded warehouses and resold the same at a profit. It carried the whiskey left over from each distilling season to various stages of maturity, and as opportunities were afforded disposed of it to the trade. (R. 31.)

The whiskey was sold under contract prior to the time it was distilled. The whiskey was distilled in the fall and spring after the contracts were

made and was placed in Government bonded warehouses and the warehouse certificates turned over to the owners of the whiskey according to the quantities purchased. After the whiskey had remained in the warehouses for the time required by the Government regulations, usually four years, it was bottled in bond under Government supervision by the Large Distilling Company for the owners. (R. 32–33.)

"Large" whiskey, by which name the product of the Large Distilling Company was generally known, was distributed by wholesale and retail liquor dealers throughout the United States. It was generally regarded by the wholesale trade as one of the leading rye whiskeys of the country. Until the Large Distilling Company ceased distilling for beverage purposes in 1917, there had been a steady growth in the demand for its product. The company seldom operated its distillery to its full capacity. The practice was to determine upon the quantity of whiskey to be distilled in the following season before soliciting contracts. The quantity specified in the contract of a particular wholesale dealer was usually based upon the quantity upon which that dealer was making tax payments. The purpose of this method was to prevent as far as practicable speculation in warehouse receipts for "Large" whiskey. Because of these practices, the demand for the product generally exceeded the supply. (R. 33.)

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Between 1899 and 1913, the Large Distilling Company expended for advertising the sum of $82,500.02, and between 1914 and 1921, inclusive, it expended for the same purpose the sum of $86,155.61. (R. 33.)

In addition to the amounts expended for advertising, the Large Distilling Company, between 1899 and 1913, inclusive, paid its customers the total sum of $55,781.10 for leakage, and between 1914 and 1921, inclusive, it expended for that purpose the total sum of $13,300.14. Leakage refers to the evaporation while the whiskey is stored in the Government bonded warehouses in excess of the Government allowance and upon which the owners of the whiskey were required to pay the tax. The tax on excess evaporation was paid by the owners, and they were reimbursed by the Large Distilling Company, although there was no specific provision in the contracts under which the company could be held liable. (R. 33–34.)

On July 19, 1897, the Large Distilling Company purchased a trade-mark for $5,000 cash. On March 1, 1913, the Large Distilling Company owned five trade-marks or trade names. (R. 34.) The petitioner was not paid any salary for his personal services from the time he became a partner in the Large Distilling Company in 1884 to and including the year 1912. The Board found that a reasonable compensation for the period between 1908 and 1912, inclusive, for the services he rendered would have been $15,000 per annum. (R. 35.)

The last whiskey produced by the Large Distilling Company for beverage purposes was distilled in May, 1917. Distilling ceased then because of war-time prohibition. The taxpayer believed in 1918 that because of war-time prohibition and the progress which had been made towards the adoption of the Eighteenth Amendment the distilling part of the business of the Large Distilling Company was ended and the business would be wound up and liquidated within four years. In 1919 the petitioner became aware that he could manufacture whiskey for medicinal purposes and in the fall of that year the Large Distilling Company resumed distilling operations for the production of whiskey for medicinal purposes and continued such operations until about November 23, 1921. On November 23, 1921, Congress enacted the so-called Willis-Campbell Act, c. 134, 42 Stat. 222, which provided in effect that whiskey could be manufactured for medicinal purposes only under permits issued by the Commissioner of Internal Revenue. No permit was obtained by the taxpayer for distilling thereafter and at the time of the hearing of this case before the Board no permits had been issued under the Willis-Campbell Act. (R. 35–36.)

The Large Distilling Company manufactured whiskey for medicinal purposes in 1919 in the amount of 396 barrels, in 1920 in the amount of 5,858 barrels, and in 1921 in the amount of 10,400 barrels. (R. 36.)

Of the physical properties of the Large Distilling Company none, except the bonded warehouses, have been put to any use since about November 23, 1921. The Board found that the salvage value of the physical properties, not including the bonded warehouses, was $19,375. The four bonded warehouses owned by the Large Distilling Company were of the rack type of construction for the storage of whiskey in barrels and were not adaptable to any other purpose. Their total capacity was 55,000 barrels. All four of the warehouses were being used for the storage of whiskey as late as 1923 and at all times during the taxable years. (R. 37.)

Prior to January 1, 1918, the Large Distilling Company disposed of the whiskey it manufactured in bulk to the wholesale liquor trade. The sales made after that date have been made to persons holding Government permits to purchase whiskey for medicinal purposes and have consisted entirely of bottled-in-bond whiskey. (R. 37.)

The firm of Schuetz, Renziehausen & Company was founded in 1879, and after 1892 until it was liquidated in 1925 the business was carried on by Schuetz and the petitioner. The business of the partnership was that of wholesale liquor dealers, selling brandies, cordials, fine liquors, and wines. At March 1, 1913, and thereafter until the adoption of the Eighteenth Amendment, the firm enjoyed the patronage of the most substantial retailers in the territories in which it did business.

On March 1, 1913, the firm owned registered trademarks for "Fort Pitt Whiskey," "Diamond Monogram Whiskey," and "Crusader Dry Gin." (R. 37–38.)

In 1908 there was opened on the books of the Large Distilling Company an account designated "old whiskey." At the close of each distilling season the whiskey manufactured and not sold was charged to this account and carried to maturity when it was sold to the trade through the organization of the Large Distilling Company. In 1922 all of the whiskey then carried in this account was sold. It had all been held for profit for more than two years prior thereto. The Commissioner refused to tax the profit from the sale of this whiskey as a capital gain at the rate of 12½% under the provisions of Section 206 of the Revenue Act of 1921. (R. 39.)

The Commissioner further disallowed deductions claimed for obsolescence of the tangible and intangible property of the distilling business for the years 1918 to 1921, inclusive, deductions claimed for loss of such intangibles for the year 1919, and those claimed for obsolescence of the intangible properties of the wholesale liquor business for the years 1918 to 1920, inclusive. (R. 30.) The Board of Tax Appeals held that the tangible property of the distilling business, except the warehouses, became obsolete in 1921 and that the petitioner was entitled to deduct from income for that year as a loss the

depreciated cost of such property less the salvage value. The Board also allowed deductions for obsolescence of the warehouses in 1921 and 1922 measured by the decrease in useful value thereof in those years. All other deductions disallowed by the Commissioner were sustained by the Board. Upon review taken by both the petitioner and the respondent the Circuit Court of Appeals for the Third Circuit affirmed the decision of the Board.

SUMMARY OF ARGUMENT

The respondent contends that the Board of Tax Appeals and the appellate court below correctly held that no deduction for obsolescence of the good will, trade-marks, trade brands and trade names of the distilling business or the wholesale liquor business was allowable inasmuch as the obsolescence deduction provided by Section 214 (a) (8) of the Revenue Acts of 1918 and 1921 was not intended to apply to intangibles such as good will. The argument in support of this view is identical with that presented in the brief for the collector in the case of *Clarke, Collector* v. *The Haberle Crystal Springs Brewing Company,* No. 68, October Term, 1929. It was therein contended that in enacting the various Excise or Revenue Acts from 1909 until the Revenue Act of 1918, Congress provided for deduction from income for depreciation only on account of those assets which were consumed or used up in the taxpayer's trade or business and that in enacting the Revenue Act of 1918, Congress did not intend to

extend the scope of the depreciation deduction but meant to confine it to wasting assets; that by including an allowance for obsolescence in the depreciation deduction under the Revenue Act of 1918 it was not the legislative intent to add any new species of property to that previously subject to the depreciation allowance and that the obsolescence deduction there provided for wasting assets does not apply to such an intangible property as good will.

Even if an obsolescence deduction were allowable in respect of good will and the kindred intangibles, such deduction can not properly be allowed in this case with respect to the intangibles of the distilling business, since during the years for which the deduction was claimed there was no obsolescence in fact.

The petitioner is not entitled to a deduction in the year 1919 under Section 214 (a) (4) of the Revenue Act of 1918 for loss based on the cost of the intangibles of the distilling business. During 1919 and 1920 and until late in 1921, the petitioner continued to manufacture whiskey and to sell his product to those permitted to buy for medicinal purposes. The business was not abandoned during the year 1919, and the good will was not discarded or destroyed. No loss was sustained during the year within the meaning of Section 214 (a) (4). Even if a loss deduction were allowable in the year 1919, the petitioner has not proved the cost of the intangible assets as the basis for the amount to be allowed.

Deductions claimed for obsolescence of the tangible properties of the distilling business for the years 1918, 1919, and 1920 were properly disallowed. The Board permitted a deduction for the year 1921 of the depreciated cost of the plant and its equipment less the salvage value as a loss sustained by abandonment due to obsoleteness and also allowed a deduction for obsolescence of warehouses in 1921 and 1922. The evidence supports the view of the Board and the Circuit Court of Appeals that obsoleteness of the tangible property was not foreseen in 1918, 1919, or 1920. As the petitioner bore the burden of proof it was incumbent upon him to show that obsoleteness could have been foreseen in these years. *United States* v. *Rindskopf,* 105 U. S. 418; *Wickwire* v. *Reinecke,* 275 U. S. 101. In the absence of proof of this material fact the disallowance of the deduction should be sustained. *Botany Mills* v. *United States,* 278 U. S. 282.

The "old whiskey" sold by the petitioner in 1922 was not a capital asset; it represented a product of his capital and labor, manufactured for sale and not acquired for profit or investment, and was stock in trade which would properly be included in his inventory. Therefore, the profits realized on the sale of a portion thereof in 1922 were not to be taxed under the capital gain provisions of Section 206 of the Revenue Act of 1921.

ARGUMENT

I

THE PETITIONER IS NOT ENTITLED TO ANY DEDUCTION FOR THE YEARS 1918, 1919, 1920, AND 1921 FOR OBSOLESCENCE OF TRADE-MARKS, TRADE BRANDS, TRADE NAMES, OR GOOD WILL OF THE LARGE DISTILLING COMPANY OR OF THE FIRM OF SCHUETZ, RENZIEHAUSEN & COMPANY

The petitioner contends that as the owner of the entire business of the Large Distilling Company he is entitled, under Section 214 (a) (8) of the Revenue Acts of 1918 and 1921, to a deduction from income for the years 1918, 1919, 1920, and 1921, for obsolescence of the good will, trade-marks, trade brands, and trade names of the business resulting from Federal prohibition legislation, such deduction to be based upon a March 1, 1913, value of those intangibles in the amount of $1,000,000. He also claims the right to an obsolescence deduction in the years 1918, 1919, and 1920 on account of the good will of the wholesale liquor business of Schuetz, Renziehausen & Company, a partnership in which he owned a one-half interest; this deduction to be based on a March 1, 1913, value of $115,000.

Respondent's position is that the Board of Tax Appeals and the Circuit Court of Appeals correctly held that the deductions were not allowable since it was not the legislative intent in enacting Section 214 (a) (8) of the Revenue Acts of 1918 and 1921 to provide an obsolescence deduction for intangibles

such as good will, trade-marks, trade brands or trade names.

The argument in support of this position is substantially identical with that made in the brief for the collector in *Clarke, Collector,* v. *The Haberle Crystal Springs Brewing Company,* No. 68, October Term, 1929, copies of which we have supplied to counsel for the petitioner herein. The discussion in the *Clarke case* was limited to obsolescence of good will under Section 234 (a)(7) of the Revenue Act of 1918, the provisions of which are identical with those of Section 214 (a) (8) of the Revenue Acts of 1918 and 1921. The value of the trade-marks, trade brands, and trade names is so dependent upon and so closely related to good will that all may properly be considered as a single class. Petitioner has not undertaken to segregate them. The argument for the Collector in the *Clarke case* regarding obsolescence of good will is equally applicable to the good will, trade-marks, trade brands, and trade names in the instant case.

It is submitted further that, even if it were to be admitted that an obsolescence deduction may be applied to good will, under the facts in this record, which differ from those in the *Clarke case, supra,* in the respects mentioned below, no such deduction may be allowed for the intangibles of the distilling business during the years 1918, 1919, 1920, and 1921. The *Clarke case* involved the good will of a brewery, the product of which was not required for

medicinal purposes after the enactment of prohibition legislation, as was the petitioner's distillery product. Also, in that case it was found as a fact that national prohibition destroyed the good will of the Haberle Crystal Springs Brewing Company. There is no such finding here. As long as the petitioner herein was able to manufacture or dispose of his product, the good will of his business was not obsolete, and until obsoleteness may reasonably be foreseen there is no obsolescence in fact. For the reasons set forth herein under point III in the discussion of the disallowance of obsolescence deductions for the tangible assets, we contend that the evidence in this case shows clearly that there was no obsolescence in fact of the good will during the taxable years. Therefore, to avoid repetition, we respectfully refer the Court to our argument under point III.

II

THE PETITIONER IS NOT ENTITLED TO A DEDUCTION IN 1919 FOR LOSS OF THE INTANGIBLE PROPERTIES OF THE DISTILLING BUSINESS UNDER SECTION 214 (A) (4) OF THE REVENUE ACT OF 1918

The petitioner contends in the alternative that if deductions for obsolescence of the good will, trademarks, trade brands and trade names of the distilling business are not allowable for the years 1918 to 1921, inclusive, he is entitled under Section 214 (a) (4) of the Revenue Act of 1918 to a deduction in 1919 for the loss of such properties based on their cost.

This section only permits the deduction of losses "sustained during the taxable year," and refers to losses actually realized. *Brewer* v. *Orr,* 19 F. (2d) 230. The provision necessarily requires that it be a complete and definitely ascertained loss fixed by an identified event such as an actual abandonment, a sale or a destruction of the property. Cf. *United States* v. *White Dental Co.,* 274 U. S. 398, 401; *Lewellyn* v. *Elec. Reduction Co.,* 275 U. S. 243, 246–247; Regulations 45 (1920 Ed.), Arts. 141, 143.

Good will is only an incident to a going concern or business having locality or name, and is not susceptible of being disposed of independently. *Metropolitan Bank* v. *St. Louis Dispatch Co.,* 149 U. S. 436, 446. The petitioner's good will and the value of the trade-marks, trade brands, and trade names were inseparable from the business itself and a loss on account of such intangibles can therefore only be reflected in the loss sustained in the sale or abandonment of the business. In denying a claim similar to that made by the petitioner, the Circuit Court of Appeals for the Eighth Circuit in *Red Wing Malting Co.* v. *Willcuts,* 15 F. (2d) 626, certiorari denied, 273 U. S. 763, said in part (pp. 633–634):

> We turn, therefore, to the question of whether the allowance claimed can be made under section 234 (a), subsection (4). It is suggested in the reply brief of plaintiff that, if defendant's argument be conceded to be correct as to the obsolescence feature

of the statute, this court could decide the case under the loss section, section 234 (a), subsection (4)[1] hereinbefore set out, and it is claimed that under the pleadings the requested allowance could be granted under that subsection as a loss sustained in plaintiff's fiscal year ending August 31, 1918.

* * * * *

We have heretofore pointed out that good will has no existence separate and apart from an established business. With the termination of that business it is ended. While a capital asset, it is not the subject of purchase, sale, or assignment separate from the business itself. It is not an assignable asset distinct from the business. It is different in this respect from such intangibles as patents, contracts or franchises which may be sold. When a business is disposed of its value and realized selling price may be enhanced by the existence of good will. If sold at a loss, the loss of good will is reflected in the transaction. The claim is somewhat novel, therefore, and rather startling, that loss of good will can be made the subject of an independent claim for a tax reduction, separate and distinct from the business of which it is an incident.

When the property of the Red Wing Malting Company was sold at a depreciated value by reason of prohibition, the loss of good will was reflected in the general loss. This loss might possibly be a basis for a deduction un-

[1] The section referred to applies to corporations as does Section 214 (a) (4) to individuals and is in the same words.

> der section 234 (a), subsection (4), of the statute. We are not advised whether or not such allowance has been made. To hold that a claimant is entitled to segregate good will from the property and business to which it is attached as an incident, and from which it is inseparable, and permit a separate deduction for its loss, might result in a double deduction and have far-reaching consequences. If the court is to open the door to claimants for tax deductions under the statute for the loss of good will apart from the tangible property with which it is connected, the right should clearly appear from the statute. We think it does not so appear.

It is submitted that the findings show that a loss of good will, trade-marks, trade brands, or trade names was not sustained in the year 1919. During that year and succeeding years until the late fall of 1921, the petitioner continued to manufacture whiskey and to sell his product to persons or firms having Government permits to buy for medicinal purposes. As late as 1921 the petitioner expended money for advertising. (R. 33.) After the enactment of the Willis-Campbell Act distilling operations ceased, but the petitioner continued to dispose of the whiskey on hand. The good will, trade-marks, trade brands, and trade names were not abandoned, discarded, or lost during the year 1919. Under these facts, a deductible loss was not sustained. Cf. *Dick & Brothers Quincy Brewing Co.* v. *United States,* No. F–146, United States

Court of Claims, decided May 6, 1929. These intangibles may have suffered a substantial decline in value, but "the statute obviously does not contemplate and the regulations (Art. 144) forbid the deduction of losses resulting from the mere fluctuation in value of property owned by the taxpayer." *United States* v. *White Dental Co., supra,* p. 401.

Moreover, the principle announced in the *Red Wing case* is correct, and since there was no sale or abandonment of the petitioner's business during the year 1919 there could not be a separate and independent deduction in the year for loss of good will.

Even if the loss deduction could otherwise be allowed for the year 1919, there is no adequate proof of the cost of the intangible assets and therefore nothing upon which the amount of the loss, if any, can be determined. The cost is alleged to have been incurred as follows (R. 40):

For services rendered by petitioner without compensation 1884 to 1913 (29 years at $15,000 per annum)	$435,000.00
Advertising, 1899 to 1913	82,500.02
Leakage, 1899 to 1913	55,781.10
Trade-mark acquired for cash, July 19, 1897	5,000.00
Total cost of intangibles	578,281.12

It is difficult to follow the contention of the petitioner that the total value of his services for twenty-nine years at $15,000 a year was part of the cost of any of the intangible assets. After the year 1897 he operated the Large Distillery as a sole proprietorship. In other words, the Large Distilling Company was Frederick C. Renziehausen. It made no

difference whether he paid himself a salary of $15,000 a year or withdrew that amount as profits. But assuming that the Large Distilling Company may be considered as an entity separate from the petitioner, the fact that it paid him no salary meant only that the cost of the liquor produced each year was just that much less and the profits—his profits—just that much more. But in no event could the value of his services be a part of the cost of good will.

Neither can it be said without further proof that the cost of advertising was part of the cost of the intangible assets. Advertising is one of the most ordinary and necessary expenses for each year's business. Only under unusual circumstances do expenditures for advertising comprise a part of the cost of good will. Cf. Article 101, Regulations 45; *Richmond Hosiery Mills* v. *Commissioner,* 29 F. (2d) 262, certiorari denied, 279 U. S. 844.

The petitioner also contends that the amounts paid for leakage constituted part of the cost of the intangible assets. The purpose in making the payments does not appear. If they were ordinary and necessary expenses, as they seem to have been, they were no part of the cost of the intangible assets.

All of the amounts which it is contended constituted the cost of the good will, with the exception of the amount of $5,000 cash paid out for a trade mark in 1897, are in the usual course ordinary and necessary business expenses. Salaries and adver-

tising are paid for every year. They enter into the cost of the year's output and do not normally go into the purchase price of any capital asset. The same is true of the amounts paid for leakage. If any part of the amounts paid for the various items do constitute capital expenditures, there is nothing in the record to show how much went into the purchase of the intangible assets and how much constituted the ordinary business expenses. The petitioner had the burden of proving his right to the deduction and the amount to which he was entitled. It is significant that the Board, although requested by the petitioner so to do, failed to find the cost of the good will. From the evidence adduced it was impossible.

It is submitted that the petitioner is not entitled to a deduction for obsoleteness of the intangible assets and that in any event there is no proof of the cost of the assets upon which to base a loss deduction.

III

THE PETITIONER IS NOT ENTITLED TO DEDUCTIONS FROM INCOME FOR THE YEARS 1918 TO 1921, INCLUSIVE, OF ANY AMOUNTS FOR THE OBSOLESCENCE OF THE TANGIBLE PROPERTY OF THE LARGE DISTILLING COMPANY IN EXCESS OF THE DEDUCTIONS ALLOWED BY THE BOARD OF TAX APPEALS

The petitioner claims the right to a deduction for obsolescence of his plant, equipment, and warehouses for the years 1918 to 1921, inclusive, under Section 214 (a) (8) of the Revenue Acts of 1918

and 1921. It will be noted that the Board of Tax Appeals allowed a deduction for 1921 of the depreciated cost of the plant and equipment less the salvage value, exclusive of warehouses, or $147,582.06. (R. 43.) This was permitted on the theory that it was a loss sustained for obsoleteness of such property caused by the enactment on November 23, 1921, of the Willis-Campbell Act, prohibiting the manufacture of spirituous liquor for medicinal purposes except under permit from the Commissioner, as a result of which the petitioner abandoned distilling operations and ceased to use the plant and equipment. The Board also held that as a result of the Willis-Campbell Act obsolescence of the warehouses began in 1921 and consequently allowed for 1921 and 1922 a deduction for obsolescence based upon the proportionate loss of usefulness of the warehouses. (R. 43–45.) These allowances were affirmed by the Circuit Court of Appeals. (R. 116–117.) Deductions for obsolescence of the tangible properties were disallowed for 1918, 1919, and 1920.

Obsolescence is the state of becoming obsolete. Obsoleteness refers to a situation where the commercial usefulness of an asset ends before the expiration of its physical life. The state of obsoleteness is reached when property which can not be used for any other purpose is no longer useful for the purpose for which it was acquired. From its very nature, therefore, obsolescence begins only when, from the existing facts, a taxpayer has sub-

stantial reason to believe that assets would not be useful in his own or any other business at some fairly definite time in the future when they must be abandoned before the expiration of their normal physical life. *Cf. Lassen Lumber & Box Co.* v. *Blair,* 27 F. (2d) 17. It is submitted, therefore, that the material and controlling fact necessary to sustain such deductions in the years 1918, 1919, or 1920, must be present, namely, that it must have been known with reasonable certainty that the commercial usefulness of the petitioner's plant and equipment would end at a fairly definite time before the expiration of their physical life. This controlling fact is lacking in the instant case and the evidence supports the view that in those years these assets were not obsolescing.

The petitioner testified that in 1918 he believed the whiskey business was through, that "the jig was up." However, in 1919 he had occasion to revise his opinion when he saw that he would still be able to manufacture and dispose of his product for medicinal uses. (R. 77.) This manufacture was continued until in November, 1921, the enactment of the Willis-Campbell Act and the refusal of the Commissioner to issue permits caused the petitioner to discontinue his distilling operations. The enactment of that Act and the Commissioner's refusal were the events which caused his plant and equipment to be abandoned. The petitioner manufactured 396 barrels of medicinal whiskey in 1919, 5,858 barrels in 1920, and 10,400 barrels in 1921 up

to November 23. Had it not been for the enactment of the Willis-Campbell Act in 1921, the plant and equipment would not have become obsolete in that year.

From the petitioner's testimony it appears that this legislation was not foreseen during the years 1918, 1919, and 1920 or at any time prior to its enactment. He testified (R. 77–78):

> In the fall or summer of 1919, we found out that we were mistaken in the assumption in 1918 that the business would have to be wound up in four years, and we kept on making whiskey until the passage of the Willis-Campbell Act. The brewers wanted to make whiskey and Senator Willis wanted to stop them and he commenced to jamb what was known as a beer bill through Congress and they put in that joker that distilleries would have to stop manufacturing whiskey, too, and we made whiskey up until the 23d. If the old brewers had stayed out we would be making whiskey today.
>
> Q. It was a bolt out of a clear sky, wasn't it?
>
> A. What is that?
>
> Q. That was a bolt out of a clear sky?
>
> A. We did not know.
>
> We did not think that the Republican Party would allow the Willis-Campbell Act to pass. The whole thing was in the Democratic Party, and the Republicans ought to have kept their hands off. They ought to have pulled Willis away and say "lay low."

In view of this testimony, the argument in petitioner's brief (p. 35) that the Willis-Campbell Act was foreseen loses its force. As the petitioner was enabled to continue and did continue the use of his plant and equipment and warehouses during the taxable years, and as there were no reasonable grounds to believe at that time that the use would be destroyed, there was no obsolescence in fact and no deduction should be allowed.

Further, in order to allow deductions for obsolescence there must be some basis upon which the amount can be computed. In the case of ordinary depreciation it is known with reasonable certainty what the life of the property will be and consequently depreciation can be computed upon that basis. In such cases there is always a time when the depreciation commences and a time when it ends. In the case of obsolescence, which is only accelerated depreciation, it is likewise necessary to know approximately when the obsolescence commences and when it ends. The petitioner apparently contends that the obsolescense of his tangible properties commenced with the submission by Congress of the Eighteenth Amendment to the various States and that the obsolescence ended with the passage of the Willis-Campbell Act.

The submission by Congress of the Eighteenth Amendment to the various States did not start obsolescence of the petitioner's tangible properties. As heretofore shown, he continued to use those

tangible properties until 1921. Likewise, in 1918 it could not have been said that the Willis-Campbell Act would be passed in 1921, nor did that Act, when finally passed, end any period of obsolescence. In other words, there is no basis upon which obsolescence deductions could be based. There is no point of time at which it could be said that obsolescence started nor is there any point of time at which it can be said that obsolescence was complete. The loss of usefulness or the obsoleteness of the petitioner's plant and equipment was not foreseen nor was it gradual; it was sudden and complete. This loss has been allowed by the Board for 1921, and the allowance has been sustained by the Circuit Court of Appeals. The gradual loss of useful value of the warehouses began in 1921 and likewise has been allowed.

In this proceeding before the Board, the petitioner bore the burden of proof. Cf. *United States* v. *Rindskopf*, 105 U. S. 418; *Wickwire* v. *Reinecke*, 275 U. S. 101; *Botany Mills* v. *United States*, 278 U. S. 282. To justify a deduction for obsolescence it was incumbent on him to show the cardinal fact that obsoleteness at some fairly definite time in the future could be anticipated.

We submit that this fact was not proved and that on the contrary the evidence shows that obsoleteness was not foreseen. In the absence of this controlling fact, the disallowance of the deductions should be sustained. *Botany Mills* v. *United States, supra.*

IV

THE PETITIONER IS NOT ENTITLED TO HAVE THE PROFIT FROM THE SALE OF WHISKEY IN 1922 TAXED AS A CAPITAL GAIN, UNDER SECTION 206 OF THE REVENUE ACT OF 1921

The petitioner contends that the sale of the "old whiskey" in 1922 was a sale of capital assets within the meaning of Section 206 (a) (6) of the Revenue Act of 1921 and taxable at the rate of 12½% in accordance with the provisions of Section 206 instead of at the usual normal and surtax rates. Section 206 (a) (6) provides that the term "capital assets" as used in the section means property acquired and held by the taxpayer for profit or investment for more than two years, not including stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year.

The petitioner and the Large Distilling Company were one and the same; the Large Distilling Company was simply the name under which the petitioner as an individual traded and did business. (R. 79.) Such business embraced both the manufacture of whiskey and its sale and the "old whiskey" account carried on the books merely represented whiskey manufactured but not sold during the year in which it was manufactured. Portions of such whiskey were sold at various stages of maturity in years prior to 1922, the year here involved. (R. 31.)

The petitioner attempts to make a distinction between the manufacture of whiskey on contract and

the manufacture of whiskey not on contract and the aging and holding of it for future sale. The distinction, if any, is one without a difference. In both cases the whiskey manufactured, whether represented by warehouse receipts or contracts or by the actual whiskey itself, was the stock in trade and inventory of the manufacturer. The taxpayer in this case was engaged in both businesses. He manufactured whiskey previously sold on contract. He also manufactured whiskey, kept it and aged it, and later sold it. Whiskey of the latter class was in no sense a capital asset within the general meaning of the term, which contemplates a permanent business asset the use or employment of which gives rise to income. It was not *acquired* for investment within the meaning of the Act, since it merely represented whiskey manufactured for sale in the usual course of petitioner's business and remaining unsold at the end of the year.

It may be noted that in the petitioner's statement of the case (Br., p. 6) it is said that in 1908 he commenced to invest his excess funds in this whiskey. The only finding in this respect is as follows (R. 39):

> In 1908 there was opened on the books of the Large Distilling Company an account captioned "Old Whiskey." At the close of each distilling season the whiskey manufactured and not sold was charged to this account and carried to maturity when it was sold to the trade through the organization of the Large Distilling Company. * * *

> Renziehausen regarded the whiskey carried in this account as a personal investment. Over a long period of time the petitioner Renziehausen had carried personal investments on the books of the Large Distilling Company.

This is entirely consistent with the respondent's position that the whiskey represented the product of the petitioner, manufactured and sold in the usual course of his business. We submit that the whiskey, whether old or new, represented income arising from the employment of capital assets and labor and not an asset acquired for profit or investment within the meaning of Section 206 (a) (6).

The old whiskey was stock in trade, to be included in the petitioner's inventory if on hand at the end of the year with as much reason as unsold whiskey manufactured during the year. Time was required to age it and the aging was only a part of the normal process of its manufacture. The treatment in a separate account or the fact that the old whiskey remained on hand for more than two years before sale can not change its character from stock in trade to a capital asset. We submit that no essential difference exists between the old whiskey and any goods purchased by a merchant or manufactured in a business and not sold within two years from the time of such purchase or manufacture.

The petitioner contends that as the business of the Large Distilling Company was in the process

of liquidation after November 23, 1921, all stock in trade or inventory became a capital asset. The evidence does not show the nature of the liquidation or what steps had been taken in 1921 or 1922. No reason is shown or can be perceived to indicate that the beginning of liquidation could change the character of inventoriable stock in trade and work a conversion into capital assets. And, as has been pointed out, the Act requires that the asset shall be *acquired* for profit or investment; and if it is not originally so acquired, but was acquired by manufacture for sale in the usual course of the petitioner's business, liquidation can not relate back to or alter the purpose of the acquisition.

It is submitted that the profits realized on the sale in 1922 of whiskey carried in the "old whiskey" account can not be taxed specially under the capital gain provisions of Section 206 of the Revenue Act of 1921.

CONCLUSION

It is respectfully submitted that the judgment of the Circuit Court of Appeals should be affirmed.

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